

MasterCard Worldwide
Law Department
2000 Purchase Street
Purchase, NY 10577-2509
tel 1-914-249-2000
www.mastercard.com



September 30, 2011

Via Electronic Mail

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Docket No. R-1404 and RIN No. 7100 AD 63

Dear Ms. Johnson:

MasterCard Worldwide ("MasterCard")¹ submits this comment letter in response to the interim final rule ("Interim Rule") issued by the Board of Governors of the Federal Reserve System ("Board") to implement the fraud prevention adjustment standards in Section 920(a)(5) of the Electronic Fund Transfer Act. The Interim Rule is § 235.4 of the Board's new Regulation II.² MasterCard appreciates the opportunity to provide its comments on the Interim Rule.

Benefits of the Non-Prescriptive Approach

MasterCard supports the Board's decision to follow the "non-prescriptive" approach that was outlined in the Board's December 2010 proposal. Under this approach, the Interim Rule permits a covered issuer to recover 1 cent per transaction as a fraud prevention adjustment, in addition to the 21 cent plus 5 basis point interchange fee limit, if the issuer adopts and follows certain fraud prevention policies and procedures. Specifically, the Interim Rule provides that these procedures must be reasonably designed to: (i) identify and prevent fraudulent transactions; (ii) monitor the incidence,

¹ MasterCard advances global commerce by providing a critical link among financial institutions and millions of businesses, cardholders and merchants worldwide. In the company's roles as a franchisor, processor and advisor, MasterCard develops and markets secure convenient and rewarding payment solutions, seamlessly processes more than 20 billion payments each year, and provides analysis and consulting services that drive business growth for its banking customers and merchants. With more than one billion cards issued through its family of brands, including MasterCard®, Maestro® and Cirrus®, MasterCard serves consumers and businesses in more than 210 countries and territories, and is a partner to 22,000 of the world's leading financial institutions. With more than 25 million acceptance locations worldwide, no payment card is more widely accepted than MasterCard.

² See Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,478 (July 20, 2011).

reimbursement and losses with respect to fraudulent transactions; (iii) respond appropriately to suspicious transactions so as to limit losses and prevent fraudulent transactions; and (iv) secure debit card and cardholder data.³

MasterCard believes the Interim Rule's flexible approach is preferable to a more prescriptive one because, in MasterCard's experience, issuers are constantly assessing the business case and value proposition that different fraud prevention technologies offer and must be free to exercise their independent business judgment in determining how to best combat fraud. Any technology-specific or "one-size-fits-all" mandate would undermine the current market-based incentives that drive issuer and network innovations to address fraud. Such an outcome not only would be counter-productive to ongoing efforts throughout the payment card chain to prevent fraud, but also is inconsistent with the public policy objective of protecting the payment system and encouraging the development of effective new and cost efficient ways to reduce fraud. Moreover, as the Board itself recognizes, a prescriptive approach would only serve to focus the efforts of those engaged in criminal activity.⁴

If the Interim Rule imposed a prescriptive approach on covered issuers, that approach would inevitably be imposed on exempt small issuers by market forces. The transaction volume of covered issuers represents a significant majority of debit card payments. If those issuers were subject to a prescriptive approach, competitive pressure would compel exempt small issuers to fall in line with the prescriptive approach. This result would run contrary to the statutory exemption for such issuers and must be avoided. Indeed, the intent behind the small-issuer exemption is to recognize the inherent differences in economies of scale between large and small issuers and to preserve the ability of small issuers to operate their debit card and fraud prevention programs in whatever way is best suited to the needs of their particular cardholder base.

MasterCard urges the Board not to deviate from the Interim Rule's flexible approach. The Interim Rule is consistent with the widely-held view that the card issuer is in the best position to understand and act on the needs of cardholders with respect to a particular fraud solution and business case. The Interim Rule also will enable card issuers to address debit card-related fraud in a manner that is consistent with public policy objectives in this area.

Consistent Treatment Across Transaction Types

MasterCard supports the Board's decision to not limit the fraud adjustment to particular modes of transaction authentication. Similar to the way a prescriptive approach to fraud prevention technology would have the effect of curtailing fraud innovation by issuers, application of the fraud adjustment allowance to only PIN transactions would serve as a disincentive for issuers to develop fraud-prevention techniques for other modes of authentication or to develop other methods of authentication that may be better fraud prevention tools.

Also, the Board has requested comment on whether an issuer's fraud prevention policies and procedures should include an assessment of cardholder rewards or other benefits programs that may be associated with particular authentication methods. We believe that this too is an

³ See §§ 235.4(a) and (b).

⁴ See 76 Fed. Reg. at 43484 (noting that "the risk that fraudsters may use [a technological mandate] as a way to focus their efforts to compromise card and cardholder data is material").

issue that is best left to issuers and market-based forces. However, the debit interchange limitation will already have the effect of causing issuers to assess the business case for debit card rewards and benefits programs.

A related matter with respect to transaction types that we encourage the Board to consider revisiting when issuing a final rule is the concept in Comment 4(b)(1)(i)-2 that issuers should consider encouraging cardholders to use the authentication method with the lowest level of fraud. Adequate incentives already exist for issuers to reduce fraud. We think the language in Comment 4(b)(1)(i)-2 is overly prescriptive and that the better approach is to preserve issuer flexibility in communicating fraud prevention approaches to cardholders.

Adjusting the Per-Transaction Cap

The Interim Rule's 1 cent per transaction cap prevents a significant number of covered issuers from recovering their current fraud prevention costs, exacerbating the difficult challenges such issuers face in restructuring their debit card programs in light of the interchange limitation. While we understand that the Interim Rule's cap is informed by the Board's desire to incentivize issuers to adopt cost effective fraud prevention measures, we believe the Board's approach could have the opposite effect in practice.

Because covered issuers will be unable to recover any fraud prevention costs that they incur above the 1-cent level (and regardless of the fraud cost recoupment allowable through interchange), issuers may decide to limit their per-transaction fraud prevention efforts and investment to only those that cost no more than 1 cent. In essence, the Interim Rule could have the practical result of causing issuers to engineer towards a lowest common denominator because a hard cap provides very little investment incentive for incremental improvements to fraud prevention that may exist beyond the 1-cent limitation. For example, if an additional 3 to 5 cents in allowable fraud prevention costs could materially reduce fraud levels below levels achieved through a 1-cent allowance, there is no public policy basis for disallowing an issuer from receiving the additional amount as part of the adjustment. Indeed, because effective fraud prevention technologies benefit the entire payments chain, incremental upward adjustments should be allowed and encouraged by the Board. By establishing a hard cap, however, the Board is essentially choking off the potential for fraud prevention innovations that may cost issuers marginally more to implement but are more than worth that cost in terms of overall fraud reduction. A hard cap also has the effect of discouraging development of new fraud prevention technologies that may require significant up-front costs because, apart from ongoing implementation costs, issuers may not recoup such up-front costs through a capped fraud adjustment fee that does not allow future upward adjustments.

In addition, while a 1-cent cap is relatively simple to administer at the network level, MasterCard believes any such administrative simplicity does not outweigh the benefits to the entire payment system that could accrue from incremental upward adjustments to the cap on an issuer-by-issuer or even industry-wide basis. We strongly urge the Board to consider revising the Interim Rule in a manner that would encourage additional fraud prevention investment such as through an upward allowable adjustment for covered issuers, which would enable issuers to recover investment costs that may be in excess of the 1-cent cap.

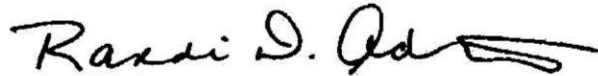
Issuer Certification

The Interim Rule requires issuers that wish to receive the allowable fraud adjustment to certify their compliance with the Board's fraud prevention standards to networks "on annual basis." The Interim Rule makes clear that networks have flexibility in working with their issuers to develop a process for this purpose. MasterCard is supportive of these aspects of the Interim Rule but asks the Board to clarify in the final rule that annual certification means anytime during a 12-month period, and not the beginning or end of a calendar year. The requested clarification would make clear that issuer certifications occurring on the Interim Rule's effective date will be deemed to be valid for one year and that an additional certification on January 1, 2012 is unnecessary.

* * * * *

Again, MasterCard appreciates the opportunity to provide comments on the Interim Rule. If you have any questions regarding our comments, please do not hesitate to contact the undersigned at 914-249-6715 or randi_adelstein@mastercard.com, or our counsel at Sidley Austin LLP in this matter, Joel D. Feinberg, at (202) 736-8473.

Sincerely,



Randi D. Adelstein
Vice President
U.S. Public Policy and Regulatory Counsel

cc: Joel D. Feinberg, Esq.